# LOCAL DEVELOPMENT AND FISCAL ACCOUNTABILITY PROGRAM

**(BO-0180)**

## EXECUTIVE SUMMARY

**Borrower and guarantor:** Republic of Bolivia

**Executing agency:** Ministry of Finance, through the National Regional Development Fund [Fondo Nacional de Desarrollo Regional] (FNDR) and the National Fund for Productive Social Investment [Fondo Nacional de Inversión Productiva y Social (FPS)

**Loan modality:** Multiphase (first phase up to five years)

**Amount and source:**

(in US$ millions)

| | Phase I (FSO) | Phase II | Total |
|---|---|---|---|
| IDB: | 47.0 | 40.3[1] | 87.3 |
| Local: | 7.6 | 5.6 | 13.2 |
| Total: | 54.6 | 45.9 | 100.5 |

**Financial terms and conditions:**

| | |
|---|---|
| Amortization period: | 40 years |
| Grace period: | 10 years |
| Commitment period: | 4 years |
| Disbursement (first phase): | 5 years |
| Interest rate: | 1% Grace period<br>2% Amortization period |
| Inspection and supervision: | 1% |
| Credit fee: | 0.75% |

**Objectives:** The objective of the program is to support Bolivia's policy for increasing municipal management efficiency in an effort to expand and improve the quality of the services that local governments provide to their communities. The contribution toward this effort will be made through direct support for municipal investment by means of *financing local development projects*, and by contributing to *improving the institutional and financial framework of the municipal sector*, particularly in terms of: (i) fiscal relations and the distribution of responsibilities among the various levels of government; (ii) approval of responsible municipal fiscal administration practices;

[1] Subject to the availability of FSO funding for Bolivia.

and (iii) the financing mechanisms (by credits and/or transfers) and control of local public spending.

The studies, discussion, and legal processing involved in assigning responsibilities, consultations, and preparation of the financing conditions are expected to take more than one political cycle to be fully completed. Also, approval of responsible practices in municipal fiscal management and fulfillment of the conditions by the municipality call for a monitoring period of at least three years to ensure that sustainable physical investment rest on a sound footing. The deepening of the financial market and its more competitive position for the municipalities requires actions and regulations to ensure that the opening up of the municipal sector to commercial bank financing takes place in a setting of sound credit and adequate guarantees to cover the different types of risk that the sector may face.

**Description:** Given the broad scope of the program's institutional objectives, the time required for consolidating fiscal and financial reforms and the reform of functions within the municipal sector, and for strengthening the municipalities themselves, the government and the Bank have agreed to view this as a multiphase operation: the first phase, with a loan of US$47 million and a duration of up to five years, and the second phase, with a loan of approximately US$40 million and a duration of an additional five years.

The components of the program are as follows:

1. **Municipal investments (US$40 million)**: Investments by means of credits and transfers will be made in urban and social development projects that correspond to the socioeconomic development priorities of the municipalities. Through credits, projects will be eligible in the traditional urban investment sectors of the FNDR (such as urban road systems, storm drains, erosion and flood protection, city services such as solid waste collection and disposal, public lighting; transportation terminals, markets, and other urban facilities, environmental protection, parks, and green spaces). Through transfers, projects are eligible in sectors defined as priorities in the national dialogue process, such as rural development (local roads, irrigation, and other sectors), education, health, micro and macro drainage projects, basic sanitation, rural energy, the environment and natural resources, institutional strengthening, and production infrastructure.

   Physical investments will be made with program funds provided that the goals agreed upon in the institutional adjustment plans (IAP) worked out with each municipality have been met.

**2. Institutional strengthening (US$11.0 million)**

**2.1 Municipal adjustment projects (US$3.8 million**) will support implementation of institutional strengthening programs in municipalities. The intent of these programs is to produce prudent financial management, verified by performance indicators established and agreed upon in agreements with the municipalities. These agreements are the outcome of comprehensive analyses to be undertaken in each municipality, which will identify the means for institutional improvement that will be supported in each case by means of credits and/or transfers. The adjustment projects will be concentrated in the following sectors: (i) integrated tax and financial administration; (ii) information and internal management control systems; (iii) human resources management systems; and (iv) means to increase the efficiency of public services (public cleaning, roadway maintenance, social and other services), by transferring or privatizing those services, or improving their management.

**2.2 Property registers (US$5.5 million)**. Financing with credits and/or transfers of at least 10 municipal property registers, in light of existing weaknesses in this area and their importance to strengthening fiscal responsibility. The property register activities and the timetable for implementing them will be established in the agreements specified in the institutional adjustment programs which will also determine the credit-transfer financing "mix" for each beneficiary municipality. The major milestones in establishing the new property registers and their functioning will be verified in the monitoring of the IAP agreed on with each municipality.

**2.3 Sector development (US$1.7 million)** consists in designing and implementing strategies for the development of municipal management, with a focus on: (i) ***Intergovernmental relations***: review of the allocation of responsibilities among the various levels of government and of the system for intergovernmental transfers; and a review of the current legislation, so that adjustments may be made to the requirements of the new institutional framework for subnational governments; (ii) ***Sector financing***: supports new financing modalities for municipalities, including the promotion of private financing for the sector, including the possibility of private members in the FNDR that will contribute to municipal financing; and (iii) ***Fiscal management***: which will support the creation and maintenance of updated databases on finances and the performance of periodic risk assessments for the municipalities, by private firms.

### 3. Program administration and supervision (US$3.1 million)

The program's administrative costs include (i) the administrative costs of program management by the DUF and the operating costs of the coordinating unit; and (ii) the costs of implementing computerized operations control systems which will serve the two funds and the DUF. The Support for Execution and Monitoring category will finance: (i) the costs of preparing the institutional assessments of the municipalities and prefectures; (ii) the promotion and dissemination of the program within municipalities throughout the country; (iii) the cost of hiring participative evaluation services and monitoring program results, based on the benchmarks in the logical framework; and (iv) the independent audit of the program, which will include concurrent audits for the FNDR and the FPS.

**The Bank's country and sector strategy:** The main objective of the Bank's strategy in Bolivia, which is the fight against poverty, follows three lines of action which, in turn, are consistent with three of the four *pillars* of the government's Operating Action Plan strategy for 1997-2002: (i) economic growth and the creation of opportunities, which includes the environment (*opportunity* pillar); (ii) human capital development and access to basic social services (*equity* pillar); and (iii) good governance and consolidation of reforms (*institutionality* pillar). The three lines of action in this operation are consistent with the above-mentioned strategy; the operation supports the results of the national dialogue with regard to the objectives of strengthening the decentralization process, economic growth, and the social development of the urban population, particularly for low-income groups.

**Environmental and social review:** The Committee on Environment and Social impact (CESI) approved the environmental and social protection procedures and the means for affected communities to participate. The urban and social development projects will have a positive impact on the beneficiary population and the environment. The municipalities environmental management capacity will be strengthened (see paragraphs 4.12 through 4.18).

**Benefits:** On the basis of its review of the sector's institutional framework, the program will help introduce efficiency criteria in intergovernmental transfers to municipal governments, providing incentives for better use of their local fiscal potential, increasing net fiscal savings, and rationalizing spending at the various levels of government. Preparation of the IAPs will also bring about responsible fiscal behavior, promoting standards of prudent borrowing and maintaining the municipalities' fiscal balance. As a result, the municipalities will be able to increase their savings capacity and generate resources for investment and for maintaining their public services, particularly services for low-income groups.

The program will create the conditions and will provide incentives for mobilizing private funds for the municipal sector, making the sector's financing more competitive. These additional resources are vital and important for the financing of income-producing projects and to promote responsible financial management in municipalities.

The modernization of management and the expansion of the range of municipal public services, supported by the program, will provide significant advantages for their users, and improve the quality of urban life. The rural development projects, financed by means of transfers, will help improve the quality of life of poor rural communities.

**Risks:** However, the country is undergoing a period of consolidation in municipal sector institutions, at the local and central levels. In attempting to modernize this framework, the program will propose changes of a legal nature that depend on broad political consensus. This poses a potential risk to achieving some of the program's sector reform objectives, but this risk is mitigated by their dynamic nature and the adjustments to policies that the multiphase modality offers.

Attaining the program's development objectives and improving the institutional performance of the municipalities also depends on the proper functioning and implementation of the government's compensation policy. The new system makes the use of transfers more transparent, requiring that the projects submitted be decided upon with the participation of the communities. The challenge lies in the response capacity of small communities and the willingness of government agents to support them. The program seeks to mitigate this risk by financing promotional and project preparation activities, and by requiring that the funds meet goals relating to their response to municipal requests. On the other hand, by adopting a multiphase loan modality and through the methodology of institutional adjustment plans that may run for up to three years, a closer relationship will be established and more frequent monitoring will be performed with regard to the actions undertaken by the municipalities, particularly with respect to the management changes that are planned, so that the necessary adjustments will be facilitated and the requisite technical support may be provided.

**Special contractual clauses:** The following are conditions precedent to the first disbursement of financing: (i) the government must demonstrate that it has created the program coordinating unit (PCU) and hired a coordinator and an accountant as agreed with the Bank (see paragraph 3.8); (ii) the Operating Regulations must be approved (see paragraph 3.16); (iii) subsidiary agreements must be signed between the Ministry of Finance and the investment funds for transfer of the financing (see paragraph 3.14); (iv) the FNDR and FPS internal procedures manuals prepared in accordance with the technical and administrative requirements agreed on in advance with the Bank must have been approved (see paragraph 3.6); and (v) drafts of the agreements signed between FNDR and FPS and each of the municipal governments concerning participation by the latter in the program must have been submitted to the Bank for approval (see paragraph 3.15).

Conditions precedent to financing for nonreimbursable transfers to municipal governments are that: (i) the government submit to the Bank the formula established for granting such transfers and the indicative allocation of those transfers to the municipalities for the initial two-year period in accordance with the technical criteria agreed on with the Bank (see paragraph 3.4); and (ii) the borrower must demonstrate that the FPS has started financing one municipal project, as established in its procedures manual (see paragraph 3.7).

As a condition precedent to disbursement of the financing for lending to municipal governments, the borrower must demonstrate that the FNDR and the FPS have formed an Approval Committee for Institutional Adjustment Plans (IAPs) (see paragraph 3.17).

The loan contract will contain three special clauses concerning the establishment of more equitable regulations that will permit the supply of municipal credit to be expanded and a suitable control structure in fund and municipalities to be assured: (i) during the period of the loan, the borrower must submit proof to the Bank each year that the FNDR is complying with the standards of the Supervisory Authority of Banks and Financial Institutions; (ii) the government will authorize Nacional Financiera de Bolivia (NAFIBO) to open a line of financing for municipal credit to be effective by month 18 after the effective date of the loan contract (see paragraph 3.11); and (iii) the outside audit of the program will include specific semiannual reports on the results of the internal control structure assessment and the review of procedures and activities relating to procurement and disbursements made by the FPS, FNDR, and municipalities, in accordance with the benchmarks agreed upon with the Bank (see paragraph 3.47).

**Poverty-targeting and social sector classification:**

This operation qualifies as a social equity-enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704).

Furthermore, this operation qualifies as a poverty-targeted investment (PTI) (see paragraphs 4.19 through 4.21).

The borrowing country will be using the 10 percentage points in additional financing (see paragraph 4.23).

**Exceptions to Bank policy:** None.

**Procurement:** Contracting will be done in conformity with Bank procedures for construction work, procurement, and hiring of consulting services. International competitive bidding will be used for construction work in amounts equal to or greater than US$2 million and procurement in amounts equal to or greater than US$350,000, in the case of goods and US$200,000, in the case of consulting services. The Bank's Country Office will perform an ex ante review of the first processes of each modality for each of the funds. Depending on its evaluation, the Country Office may grant the FNDR and/or FPS authorization for ex post implementation of the procedure in the future. Given the amount of contracting that the program involves, the FNDR and the FPS will act as supervisors of procurement procedures that will be carried out by the municipal governments themselves, based on the standard bidding documents of the program's Procurement Regulations (Annex III-1).